

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Bill Campbell Analyst: Kristina E. North Bill Number: AB 1166
Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: February 23, 2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Prescription Drug Credit/FTB Annually Report to Legislature

SUMMARY

This bill would create a 25% credit for seniors 65 years of age or older for the costs of prescription drugs.

PURPOSE OF THE BILL

The stated purpose of this bill is to offset the costs of prescription medications for low- and moderate-income seniors.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would apply to taxable years beginning on or after January 1, 2001, and before January 1, 2008.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author with amendments to resolve the concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws specifically allow unreimbursed medical care expenses, including costs for prescription drugs or insulin, to be deducted for income tax purposes. The expenses may be claimed as an itemized deduction only to the extent that they exceed 7.5% of the taxpayer's adjusted gross income (AGI). The federal law defines "prescribed drug" as a drug or biological that requires a prescription of a physician for its use by an individual.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

05/25/01

A biological could include bacterial vaccines, blood products, prions, cellular immunology, cytokines and allied mediators, diagnostics, general bacteriology, general virology, endogenous and adventitious viruses, hormones, immunochemistry, monoclonal antibodies, parasite, protein chemistry, toxins, toxoids, and viral vaccines.]

Current federal and state laws contain various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Neither **current federal nor state law** has a credit comparable to the prescription drug tax credit proposed by this bill.

THIS BILL

This bill would allow a qualified taxpayer a credit equal to 25% of prescription drugs costs. The credit may not exceed \$300 for an individual or \$600 in the case of a married couple filing a joint return.

This bill would define a "qualified taxpayer" as an individual who is 1) 65 years old or over by December 31 of the taxable year; and 2) has an AGI of \$20,000 or less. If the "qualified taxpayer" is married and files a joint return, both spouses must be 1) 65 years old or over by December 31 of the taxable year; and 2) have an AGI of \$40,000 or less.

This bill would specify that no credit may be allowed unless the 1) prescription drugs are prescribed by a licensed physician, and 2) the taxpayer retains sales receipts for proof of purchase of the prescription drugs.

This bill would specify that no credit may be allowed for an individual who was a member of a health maintenance organization (HMO) or other licensed health care facility for at least six consecutive months during a calendar year beginning with 2001 or for any following taxable year.

This bill would specify that this credit would be in lieu of any deduction or credit allowed for prescription drug costs.

Any excess credit may be carried over to reduce tax in the succeeding eight years.

This bill would require the Franchise Tax Board (FTB) to report annually to the Legislature on the use of the credit. To the extent data are available, FTB must include the number of taxpayers claiming the credit, the total and average amounts claimed, and the additional information that members of the board determine would be helpful to determine the credit's effectiveness in offsetting the cost of prescription medication for senior citizens.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's staff to resolve these and other concerns that may be identified.

- ◆ Definitions are needed for "prescription drugs," "health maintenance organization," and "other licensed health care facility." The author may wish to consider using the federal income tax law definition of prescription drugs.
- ◆ This bill would allow a taxpayer to claim this credit for prescription drugs even if the drugs are purchased for a member of the taxpayer's family or for transfer or resale to another person. If the author intends that this credit should be claimed only on drugs purchased for the use of the individual who is over 65, the author may want to consider amending the bill accordingly.

LEGISLATIVE HISTORY

SB 155 (Oller, 2001/2002) would allow a 100% credit to individuals over 55 years of age for the costs of prescription drugs that are not reimbursed or paid for by insurance. This bill is in the Senate Revenue and Taxation Committee.

AB 513 (Strickland, 2001/2002) would allow a 100% credit up to \$650 for taxpayers 65 years of older for the costs of prescription drugs. This bill is in the Assembly Revenue and Taxation Committee.

AB 2533 (Pacheco, 1999/2000) would have allowed a 25% credit for the costs of prescription drugs. The credit would have been limited to \$300 for an individual and \$600 for a married couple filing jointly. This bill failed to pass the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Michigan has a refundable prescription drug credit for individuals 65 years of age or older whose household income does not exceed 150% of the federal poverty level. The individual may not be a resident in a health care or mental care facility licensed or operated by the state. The prescription drug must be purchased directly by the individual and the cost cannot be covered by a third party reimbursement plan. The credit is not reported on the individual's tax return, but is claimed on a separate form prescribed by the revenue department.

Review of *Illinois*, *Massachusetts*, *Minnesota*, and *New York* laws found no comparable tax credits or deductions. However, both *Illinois* and *New York* are pursuing legislation in this area. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Tax Revenue Estimate

Based on data and assumptions discussed below, estimated revenue losses would be as follows.

Estimated Revenue Impact of AB 1166 As Introduced 2/23/2001 Taxable Years Beginning 1/1/2001 Enactment Assumed After 6/30/2001 [\$ In Millions]		
2001/2002	2002/2003	2003/2004
-\$5	-\$4	-\$4

Tax Revenue Discussion

The amount of prescription drug costs incurred by individuals age 65 or older and the amount of credits that could be applied to reduce tax liabilities would determine the revenue impact of the bill.

Based on household spending data for 1997, the average annual out-of-pocket expenditure for prescription drugs for individuals age 65 or older was projected at approximately \$675 for 2001. Multiplying projected prescription drug costs by the proposed credit percentage of 25% derived an average credit of \$169 in 2001, increasing to \$215 in 2004. For each year in this analysis, the calculated average credit is considerably less than the proposed maximum of \$300 per qualified individual.

A simulation was performed using personal income tax sample data. The senior exemption credit was increased by the average credit calculated above for taxpayers with AGI of \$20,000/\$40,000 or less. Assuming each qualified taxpayer in the sample generated the average credit, the simulation models the maximum revenue loss to the extent credits generated could be applied to reduce tax liabilities. Reduction adjustments were made to the model output to allow for (1) any ineligible taxpayers who were members of a health maintenance organization or other licensed health care facility for at least six consecutive months during the year, (2) for some small portion deducted under current law as a medical expense (subject to the 7.5% of AGI threshold), and (3) to reflect the rate at which qualified taxpayers would, in fact, report the credit on their tax returns.

POLICY CONCERNS

This bill does not disallow the credit for prescription expenses reimbursed by an insurance carrier; however, it does disallow the credit for a taxpayer's co-payments for prescriptions if the taxpayer is a member of an HMO or other health care facility for at least six months. Thus, this bill appears inconsistent in its treatment of similar expenses. The author may wish to make the treatment of expenses consistent.

Additionally, whether a taxpayer was or was not a member of an HMO or other health care facility for six months or more would be unverifiable. The author may wish to reconsider this requirement.

The calculated average credit for each individual is estimated to be approximately \$169 (or slightly over half of the proposed maximum credit per individual). Targeted taxpayers are not likely to have enough tax liability to utilize this credit to the \$300/\$600 maximums. The author may wish to consider a more direct method, such as a grant, to provide the desired relief.

For a married couple filing a joint return to qualify for this credit, this bill would require that *both* spouses be age 65 or older by December 31 of the taxable year. If only one spouse meets this criterion, neither spouse would qualify to claim this credit on a joint return. Taxpayers are required to use the same filing status on their California return as they used on the federal return. To claim this credit, the qualifying spouse would be required to file a separate state and federal returns, with higher rates applying. The author may wish to condition the limitation for each individual to allow the couple to claim up to a \$300 credit for the spouse who is 65 or older.

LEGISLATIVE STAFF CONTACT

Kristina E. North
Franchise Tax Board
845-6978

Brian Putler
Franchise Tax Board
845-6333